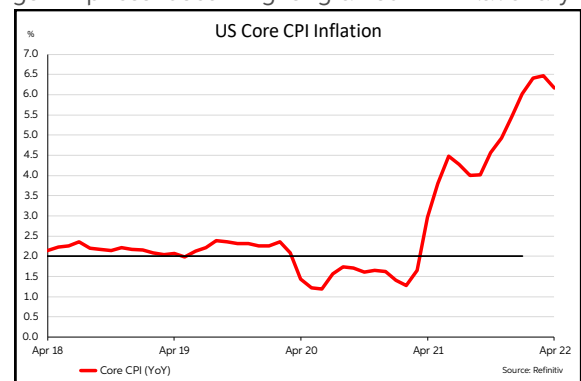


## A Long Hot Summer

- The cracks on the ECB Governing Council are becoming wider ahead of its key policy meeting next Thursday.** No changes in rates are expected at this meeting. However, some Council members are calling for a 50bps hike to be on the table in the third quarter as the ECB starts the process of raising interest rates. Others, though, are calling for rates to rise at a moderate pace, in 25bps steps.
- The inflation data for May will unnerve the ECB though, with the headline rate soaring to 8.1% from 7.4% in March and April, well ahead of expectations.** There is now marked upward pressure on food prices as well as energy costs. Meanwhile, core inflation has been on a pronounced upward trajectory over the past four months. The HICP rate, excluding energy and unprocessed food, has climbed from 2.4% in January to 4.4% by May. This indicates that price pressures are becoming more broad based in the economy.
- It is likely that we are still some months away from the peak in headline inflation.** The rise in consumer prices in the euro area during last summer was quite modest. This is unlikely to be the case this summer. Oil prices have surged higher again in the past week after the EU announced a partial ban on oil imports from Russia. This will result in further increases in household fuel and energy prices. Upward pressure is also likely to be maintained on food prices, amid concerns about global shortages. Thus, inflation in the euro area could easily reach 9% or higher by the end of the summer. This would increase the pressure on the ECB to move interest rates quickly into positive territory. Currently, its key deposit rate is pitched at -0.5%.
- Market rate expectations have hardened appreciably in recent weeks.** Futures contracts are now close to pricing in 125bps in rate hikes at the four ECB policy meetings due to be held over the second half of the year, pointing to at least one 50bps hike. This would bring the deposit rate to 0.75% by end year. Further rate hikes are anticipated in 2023, with the market looking for the deposit rate to get to 1.75% by the end of next year. The sharp rise in inflation, though, will weigh heavily on real disposable income and result in sluggish growth at best in the euro area economy over the second half of this year and well into 2023.
- We expect to see sharp revisions to the ECB's macro forecasts for 2022 and 2023 that will be published at Thursday's meeting,** with inflation projections being upped significantly and growth cut compared to the last set of projections in March. Inflation should fall appreciably later this year, but it is uncertain how quickly it will return to the 2% target. The surge in inflation is largely being driven by a surge in commodity prices amid disruptions to global supply chains. Further upward pressure on commodity prices cannot be ruled out over the winter if supply/demand imbalances continue to worsen in primary markets. There is also a risk of the recent surge in prices becoming engrained in inflationary expectations and wage setting behaviour.
- On the other hand, the likely weak economic backdrop should help inflationary pressures to eventually moderate considerably.** Overall, there is a wide margin of error in both directions around market expectations that official rates will be at 1.75% by end 2023, given all these uncertainties.
- In terms of data releases, there is a relatively quiet schedule ahead.** In the Eurozone, the final readings of Q1 GDP and employment are due. The former is set to have increased by 0.3% in the quarter, while the later is thought to have risen by 0.5%. Elsewhere, German industrial production is projected to rise by 1.0% in April, having nosedived by 3.9% in March.
- In the US, the main highlight will be the May reading of CPI inflation.** There are tentative signs inflation may have peaked, or be close to peaking in the US as both CPI and PCE inflation eased back slightly in April. However, inflation is still running at very elevated levels in the US. Headline CPI printed at 8.3% in April, while the core-rate stood at 6.2%. The consensus is for the headline rate to be unchanged in May, indicating that the road back towards the 2% inflation target level is likely to be protracted and difficult. Encouragingly though, the core rate is forecast to edge lower to 5.9%. Elsewhere in the US, the Michigan measure of consumer sentiment is expected to deteriorate in June, from an already very subdued level.
- There is a very light data docket in the UK this week.** Of the limited releases to note, the RICS Housing Survey and the Halifax house price index for May will feature.



	Interest Rate Forecasts			
	Current	End Q2	End Q3	End Q4
	2022			
Fed Funds	0.875	1.375	2.125	2.625
ECB Deposit	-0.50	-0.50	0.00	0.50
BoE Repo	1.00	1.25	1.50	1.75
BoJ OCR	-0.10	-0.10	-0.10	-0.10

Current Rates Reuters, Forecasts AIB's ERU

	Exchange Rate Forecasts (Mid-Point of Range)			
	Current	End Q2	End Q3	End Q4
	2022			
EUR/USD	1.0740	1.05	1.06	1.07
EUR/GBP	0.8553	0.85	0.86	0.87
EUR/JPY	140.19	139	142	144
GBP/USD	1.2556	1.24	1.23	1.23
USD/JPY	130.51	132	134	135

Current Rates Reuters, Forecasts AIB's ERU

Date	UK & Irish Time	Release	Previous	Forecast
<b>This Week:</b>	<b>ECB Speakers:</b>	<b>Lagarde (Fri)</b>		
	<b>BoE Speakers:</b>			
	<b>Fed Speakers:</b>			
<b>Mon 6th</b>	<b>IRL:</b>	<b>June Bank Holiday (Market Holiday)</b>		
<b>Tue 7th</b>	<b>GER:</b>	07:00 Industrial Orders (April)	-4.7%	-0.5%
	<b>EU-19:</b>	09:30 EU Sentix Index (June)	-22.6	-20.0
	<b>US:</b>	13:30 International Trade (April)	-\$109.8bn	-\$89.5bn
<b>Wed 8th</b>	<b>JPN:</b>	00:50 GDP (Q1: Revised Reading)	(-1.0%) s.a.a.r	(-1.0%) s.a.a.r
	<b>JPN:</b>	06:00 Economy Watchers Poll (May)	50.4	
	<b>UK:</b>	07:00 Halifax House Prices (May)	+1.1% (+10.8%)	
	<b>GER:</b>	07:00 Industrial Production (April)	-3.9% (-3.4%)	+1.0% (-2.6%)
	<b>EU-19:</b>	10:00 Employment (Q1: Final Reading)	+0.5% (+2.6%)	+0.5% (+2.6%)
	<b>EU-19:</b>	10:00 GDP (Q1: Final Reading)	+0.3% (+5.1%)	+0.3% (+5.1%)
<b>Thu 9th</b>	<b>CHINA:</b>	04:00 Trade Balance (May) - Exports	+\$51.1bn (+3.9%)	
	<b>IRL:</b>	<b>11:00 CPI Inflation (May)</b> <b>- HICP</b>	<b>+0.9% (+7.0%)</b> <b>+0.9% (+7.3%)</b>	<b>+1.0% (+7.9%)</b> <b>+1.0% (+8.2%)</b>
	<b>EU-19:</b>	12:45 ECB Monetary Re-fi Rate - Deposit Rate	+0.00% -0.50%	+0.00% -0.50%
	<b>EU-19:</b>	13:30 ECB Press Conference		
	<b>US:</b>	13:30 Initial Jobless Claims (w/e 30th May)	+200,000	+208,000
<b>Fri 10th</b>	<b>CHINA:</b>	02:30 CPI Inflation (May) - PPI	+0.4% (+2.1%) (+8.0%)	
	<b>ITA:</b>	09:00 Industrial Output (April)	+0.0% (+3.0%)	-1.6% (-0.6%)
	<b>US:</b>	13:30 CPI Inflation (May) - Core-CPI	+0.3% (+8.3%) +0.6% (+6.2%)	+0.7% (+8.3%) +0.5% (+5.9%)
	<b>US:</b>	15:00 Preli. Uni. Michigan Consumer Sentiment (June)	58.4	58.1

◆ Month-on-month changes (year-on-year shown in brackets)

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